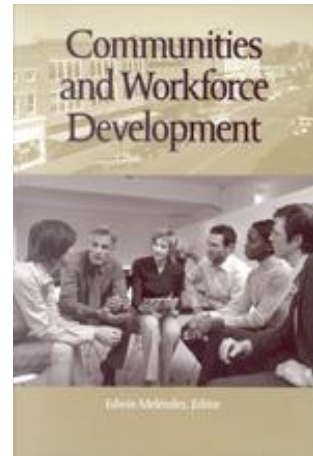




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Competing for Contracts

Nonprofit Survival in an Age of Privatization

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Competition among private providers in the delivery of employment training services may not be new, but the entrance of a few national, for-profit corporations has recently begun to reshape the employment training industry following the lifting of restrictions provided for under Temporary Assistance for Needy Families (TANF). Corporate players are changing the rules of the game in areas with a long and stable history of public-nonprofit partnerships, and the competitive pressures that emanate from the “work first” imperatives are of particular concern—especially for community-based organizations. Thus, the question of whether privatization in a performance-based environment will result in better services or distort and ultimately drive out essential, mission-driven programs bears scrutiny.

New contracting requirements and competitive demands that force nonprofits to compete with for-profits can change their priorities, requiring them to choose between meeting the market test and maintaining commitments to their primary mission. After all, “work first” eschews, in large part, longer and more intensive education and training in favor of direct job placement and short-term job readiness skills. Federal mandates to the states for caseload engagement place significant pressure on states and localities to meet their placement targets. There is also a desire by local officials to reduce costs, improve performance, and circumvent the constraints on flexibility and innovation imposed by public employee unions. Several jurisdictions have chosen competitive, performance-based contract arrangements as a solution to these pressures, awarding million-dollar contracts to a few large, profit-driv-

en corporations over community-based providers (Barnow and Trutko 2002).

This new service environment places enormous demands on all participants and will likely determine the success of many. High performing, mission-driven organizations must change to remain relevant. But regardless of their merits under a competitive, performance-based system, nonprofits and community-based providers have held a unique place in the civic infrastructure and historically have played a critical role in the job training and placement arena by providing specialized services for a diversity of needs in the community. CBOs losing out to for-profit providers may have profound effects on the quality and appropriateness of the services available—services that would change when product standardization is required to achieve economies. The speed and scale of change have allowed little systematic evaluation of CBOs' strategies and service records, and advocates of the poor, traditional providers, and public policy observers question the wisdom of rushing into public contracting with private firms. This chapter takes a look at nonprofits competing with for-profit providers in four jurisdictions. Our assessment of the likely effect of the changing environment pays particular attention to its impact on these indispensable social institutions.

The competitive contracting environment created by reengineered welfare reform delivery systems is a mixed blessing at best. Some of the market incentives have worked in the expected direction by improving organizational and service performance and increasing innovation and creative adaptations, as seen in a number of nonprofits. Likewise, as we shall see in upcoming chapters, many CBO-operated employment programs owe their success as well as their survival in this evolving industry to effective and creative interorganizational networking, which enables them to combine strengths and share administrative functions. Intermediaries play an important role in setting up these arrangements. Such examples do exist in the face of competition for TANF contract awards, including cases of for-profit–nonprofit allegiances. CBOs have historically capitalized on high quality placements and the professional training capacity that for-profit partnerships can provide. They now stand to benefit from their access to start-up capital and the technologically sophisticated systems needed to function under these new mandates. For-profits have in turn benefited from subcontracting ar-

rangements with community-based providers, tapping into their local expertise while averting the political backlash that can arise from the commercialization of this sensitive service environment.

Our investigation has revealed, however, that mutually beneficial for-profit–nonprofit partnering, and even examples of successful nonprofit collaborations, tend to be more the exception than the rule under this system. As they compete for Welfare-to-Work contracts, nonprofits in our four sites are experiencing considerable stress in making the necessary shifts to become more businesslike in organizational design, management, staffing, and culture. The degree of difficulty experienced varies considerably among nonprofit and for-profit organizations of different size, experience, sophistication and philosophy. Nonprofits vary dramatically among themselves—as much or more than they do from their for-profit competitors. For this reason, the increasing seductiveness of large government contracts and a desire to make a difference in a reengineered human services industry must be tempered by a balanced assessment of mission and capacities. The pressure exerted by private-sector competitors in all our sites is considerable, and all CBOs understand the tall challenges they face.

THE RECONNAISSANCE MISSION

In the absence of any existing national survey data that examine the impact of these new competitive demands on nonprofit providers, we undertook a reconnaissance mission to seek out existing arrangements in jurisdictions that have introduced innovations in the provision of services. Four jurisdictions, San Diego, Milwaukee, New York, and Houston (see Table 2.1) were selected based on meeting our criteria: 1) introduction of competition among vendors from each of the sectors, and 2) a change in the number and character of contractors serving TANF clients. These case studies include big operators that have had a long history in the provision of public services, as well as medium-sized and smaller agencies that have limited access to the resources and capital necessary to compete in a performance-based environment.

We can discern three types of experiences. Many large, experienced and competent organizations are meeting the challenge and, in many cases, improving their organizational systems, staff, and programming.

Table 2.1 Overview of Contract Characteristics in Four Cities

	Houston	Milwaukee	New York	San Diego
TANF client placement	Clients assigned to 1 of 30 career centers by zip code.	Clients assigned to 1 of 6 geographic regions, each with a sole provider.	TANF contracts are referred by Human Resources Administration (HRA) first to a Skills Assessment and Job Placement Center (SAP) contractor. If still without employment, client will be referred by HRA to an Employment Services and Job Placement Center (ESP) contractor.	Clients are assigned to 1 of 6 geographic regions, each with a sole provider.
Providers and sites per provider	6 contractors, each with multiple career centers.	5 contractors, all serving a single region except 1 that has received 2 regions.	5 contractors with the SAP contracts, 12 contractors with the ESP contracts.	2 contractors run single regions, while both county officials and ACS State and Local Solutions run 2 regions.
Services provided to TANF clients	Centers are assigned TANF clients; receive case management services including assessment, employment planning, job readiness and job search; refer clients for intensive job and basic skills training and on-the-job training.	Contractors complete eligibility determination and provide complete services all the way through job training and placement.	SAP contractors receive TANF clients and provide skills assessments and services through preliminary job placement centers. ESP contractors are referred clients who are not placed by the SAP contractors; they offer more intensive employment services and job training and placement.	Centers are assigned clients; they handle all case-management duties including appraisal, assessment, and job search training; if clients do not succeed in finding employment, they are referred to a work placement network.

Bidding process	Request for proposal.	Request for proposal.	Negotiated acquisition process.	Request for proposal.
Contract structure and measurement parameters	Cost reimbursement: each contractor must achieve certain levels for eligible served, clients receiving continued service, clients entering employment, and clients employed above minimum wage.	Pay for performance: contractors must achieve and can receive bonuses for achieving an entered-employment placement rate, average wage rate, job retention rate, available health insurance benefits, full and proper engagement, and basic education/job skills activities. Two optional measurements (faith-based contracts and basic education/job skills attainment) may be substituted for the bonus portion of 2 of the above categories.	Pay for performance: SAP—payment is given for assessment, engagement in employment activities, job placement (higher rate for 30+ hours), with a bonus given for high wages and 90-day placement. ESP—a percentage of base rate or a flat fee is paid for placement and 90-day retention, while a higher flat fee is paid for high wages, left welfare, or placement for 180 days.	Pay for performance: certain amounts are paid for participant engagement, active caseload, 30-day employment, and 180-day employment.
Level of sub-contracting	Relatively little.	Extensive.	Very little for SAP, extensive for ESP.	Very little.

SOURCE: Contract information provided by the following organizations: Houston Department of Human Services, Gulf Coast Workforce Board; Wisconsin Department of Workforce Development; Office of Contracts, New York City Comptrollers Office; County of San Diego, Contract Operations.

Even as they do so, however, the demands and philosophy of TANF impose programmatic emphases that compromise organizational values and challenge long-standing missions. Others, less fiscally sound, find it a struggle to develop the capacity to meet the financial and management demands of the contracts but have temporarily managed to stay afloat through a variety of innovative, short-term survival strategies. A third group is at more immediate risk, unable to make the sizable financial and organizational investments to compete, and unwilling to capitulate to the fundamental challenges to their missions that performance-based contracts entail.

In the sections that follow we discuss the current status of the nonprofit sector in the context of this changing environment. We next examine the differences in nonprofits' motivations for competing for contracts and the differential effects that their recent adjustments are having. We conclude by highlighting the potential dangers for nonprofits while citing a few promising examples of effective adaptations and solutions to the ongoing challenge of competition.

STAYING IN THE GAME

These have been turbulent times for nonprofits. The past two decades have witnessed phenomenal growth in the nonprofit sector, even as critics and expert observers have sounded the alarm. The future of the sector is under constant scrutiny, but observers' judgments about its condition depend upon whether they have an optimistic or a pessimistic outlook. Paul Light (1999) shows how today's policy environment has put pressure on nonprofits to change and has caused many organizations to feel the squeeze from several sides. Even so, he reminds us that the sector has grown in the dollars it receives from contributors and government, the size and professionalism of its workforce, and the degree to which it inspires career aspirations in a new generation who increasingly see the nonprofit sector as their destination (Light 1999). Nevertheless, the sector is being compelled to demonstrate its effectiveness. Increasingly compared with both the public and the private sector, nonprofits are being asked to justify their competence and relevance. Calls to demonstrate performance in program outcomes, good fiscal and organizational management, and efficiency have been mounting

from a more sophisticated donor base, funding institutions, boards of directors, professionalized staff, and government. Reform movements are besetting the sector (Light 1997, 2000).

Government contracts and funding represent an ever-increasing portion of nonprofits' income. In 1982, 56 percent of all social services and 48 percent of all employment and training services financed by government were delivered by nonprofits (Salamon 1995, p. 88). Between 1992 and 1998, public support for employment and training nonprofits increased by 44 percent (Lampkin and Pollak 2002, Table 5.8). Today, the government-funded portion of social services' income remains high. Although recent data on sources of funding for nonprofit employment and training providers alone are hard to find, 1997 data on the portion of revenue that nonprofit social-service organizations received from government sources put the figure in excess of 52 percent (Lampkin and Pollak 2002, pp. 100–101). This figure probably underestimates the percentage among employment and training providers, where nonprofits still provide the bulk of services to state and local governments and for whom government funding historically made up the single largest source of funding.

While the increasing reliance of state and local governments on nonprofits to deliver social services has resulted in considerable growth, it has also made these organizations vulnerable to changes in government expenditures and policies. A study that analyzed the impact of federal welfare waivers on human services nonprofits in the 53 largest metropolitan areas from 1992 to 1996 found that 26 percent failed over the period (Twombly 2000b). Another study of 13,500 nonprofits most likely to be affected by welfare reform found that of the 83 percent that were providing core services (including employment-related services), revenue was growing, but for a majority of those, expenditures were growing faster. Only 41 percent of these nonprofits had positive net balances for the two years of the latter study, 1992 and 1994 (De Vita 1999, p. 221). These data highlight the considerable vulnerability that nonprofits have to policy and funding changes. Some are better capitalized and managed; others have more diverse funding streams allowing them greater resiliency and adaptability to changing policy demands and economic fluctuations.¹ And those nonprofits that fail are quickly replaced by new entrants—at a rate of three human service providers for each one that fails (Twombly 2000b). What seems clear amid the turnover

is that greater competition, increasing dependence on government, and changing standards and expectations for nonprofit performance pose serious challenges for the future.

Fiscal, economic, and effectiveness crises represent ongoing challenges for nonprofit institutions, but Lester Salamon (1997) has identified a more fundamental crisis in the nonprofit sector as being one of legitimacy (Salamon 1997, p. 41). Salamon poses the problem as a fundamental moral and political challenge that questions the sector's continued *raison d'être*. Wedded to a nineteenth century image of charity and altruism, public support for nonprofits in the wake of their commercialization, public partnerships, and professionalization appears to be on the decline, Salamon (1997) says:

The nonprofit sector is thus being hoisted on its own mythology. Having failed to make clear to the American public what its role should be in a mature mixed economy, the sector has been thrown on the defensive by revelations that it is not operating the way its mythology would suggest. A massive gap has thus opened between the modern reality of a sector intimately involved with government and moving into commercialization in the wake of government cutbacks, and the popular image of a set of community based institutions mobilizing purely voluntary energies to assist those in need. (p. 42)

Nonprofits—both large institutions and smaller CBOs—engaged in Welfare-to-Work contracting are obliged to reexamine their missions, governance, and ways of operating, especially in a competitive performance-based service environment. Success requires that they compare themselves with private, for-profit firms and elevate market values in their decision-making about what challenges to pursue and how to pursue them. As nonprofits move through transition in this environment, they are more like the “shadow state,” says Wolch (1990): ever in conflict about the autonomy they can maintain and the participatory or democratic objectives they can pursue. “As the sector struggles to maintain itself and develop, it faces a difficult dilemma: to rely increasingly on opportunities linked to state privatization initiatives (and, hence, subject itself to increasing state control), or to maintain independence of organizational purpose but face a continuing struggle for survival and resources. Either way, the sector's survival remains at risk” (Wolch 1990, p. 19).

BEING IN THE GAME BUT KEEPING YOUR SOUL

Nonprofits that succeeded in the bidding process in the four cities we visited were generally experienced service providers with a history of contracting to government and with missions focused on serving disadvantaged populations. Many, but not all, had provided case management, employability assessment, job placement, and training services under a variety of government funding streams and private philanthropic resources. Many also had some degree of skepticism about a future under a competitive contract process with for-profit organizations, but most were motivated to participate by a commitment to serve low-income populations, as was consistent with their missions.

Most of those we interviewed held the view that the world is changing. As Nancy Liu of the Chinese Community Center in Houston said, "If you are behind the wagon, then you are behind the wagon no matter what. It doesn't matter what kind of heart that you have. There is just no money for you to have a good heart and not see what the bottom line is."² Although the role of nonprofit providers in the design of new delivery systems and contracts varied and some long-term providers expressed dismay about the lack of consultation in the system redesign process, all felt that given their experience and mission they should have a role in a redesigned system. One nonprofit executive, Sister Ramonda Duvall, executive director of Catholic Charities in San Diego, described the motivation in these terms: "We bid because we didn't trust the city to deal fairly with the poor. We wanted to have a voice at the table. The for-profits have no mission or commitment toward the poor. We thought, 'Once they get a foothold, the nonprofits would be out of business.'"³ In a presentation before a group of welfare administrators from around the country, Sister Duvall further described the motivation of Catholic Charities as emanating directly from its mission. The federal legislation compelled the organization, she said, to embrace "a unique opportunity to do it right" (Duvall 2000).

In Houston, the Community Services branch of the local AFL-CIO bid on a contract and won. Choosing to capitulate to the realities of prevailing policy rather than relinquish its role, Community Services competed in an arena that labor unions have historically opposed entering. Loath to undermine the role of public employee unions in providing public services, labor unions have consistently opposed the practice

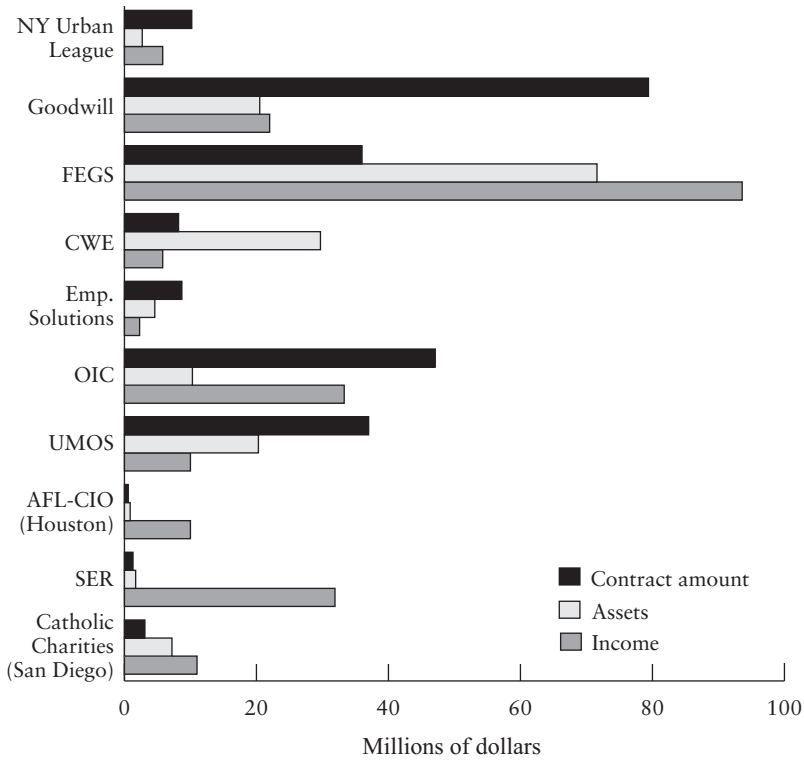
of contracting services out, and have opposed privatization in particular. However, the local AFL-CIO director, Richard Shaw, explained the situation in terms similar to those Sister Duvall used: that if allowing for-profits to compete was the direction the state was headed in, labor could not afford to sit out and lose its opportunity to be part of the competition.⁴

The nonprofit response to the changing environment is clearly a marriage of pragmatism and social mission. Among our interviewees, there was the recognition that this was the only game in town—a game where the players were eligible for far more resources than most had ever been awarded in a single contract before. (See Figure 2.1.) But this assessment was balanced by a view voiced by most of those we spoke to: that this was the business they were in, and they had a mission-driven belief that they could do it better. Amalia Betanzos, the President of Wildcat Service Corporation, which has a \$54.7 million contract with the city of New York, was particularly enthusiastic about her organization's ability to thrive under a performance-based contract and eager to demonstrate Wildcat's superiority as a provider. "We have always exceeded our benchmarks so we are pleased with performance-based contracts," she said. "We want to get paid for our results and will do well under this system. If you are good, competition is useful—compared to for-profits, our motivations are different: This is our business—this is their opportunity."⁵

Many nonprofit heads even claimed they welcomed competition from the private sector because they found that the competitive pressures made them better, and that the financial structure of their operations and their long experience in the community dealing with employers and disadvantaged clients gave them a comparative advantage. Most of the nonprofits we spoke to—and the majority of nonprofit contractors who won bids in the latest round—were relatively well capitalized and had been in the business a long time. Compared to the new entrants into the system, Betanzos said, "we know exactly what we are."⁶ Even so, asset levels, even for large nonprofits, are often rather low in comparison to the size of contracts they are taking. (See Figure 2.1 and Table 2.2.)

Goodwill Industries of New York, for example, is a large, well-established player nationally and in the New York provider community and has been in business for more than 80 years. It runs a thrift shop that recycles, repairs, and cleans used items like clothing and furniture to be

Figure 2.1 Nonprofit Income and Assets (2000) Compared with Contract Amount (2001)



NOTE: Goodwill = Goodwill Industries (New York); FEGS = Federal Employment and Guidance Services (New York); CWE = Consortium for Worker Education (New York); Emp. Solutions = Employment Solutions (Milwaukee); OIC = Opportunities Industrialization Center of Greater Milwaukee; UMOS = United Migrant Opportunities Services (Milwaukee); SER = SER-Jobs for Progress (Houston).
 SOURCE: Information from www.guidestar.org. Ten out of 13 contract providers for which data were available are included.

Table 2.2 County Contracts, Comparing Contract Size to Asset Level of Contractor

Contractor	Sector	Contract size (\$)	Assets (\$)	Income (\$)
Milwaukee				
Contract period 2002–2003				
YW Works	For-profit	65,252,410		
UMOS	Nonprofit	66,517,591	20,391,592	10,031,453
OIC of Greater Milwaukee Inc.	Nonprofit	36,940,478	1,036,517	33,363,611
MAXIMUS	For-profit	36,940,478		
San Diego				
Contract period 1998–2002				
ACS ^a	For-profit	26,442,940		
MAXIMUS	For-profit	23,967,062		
Catholic Charities	Nonprofit	11,018,718	8,347,702	12,650,131
San Diego County Agencies	Gov't entity			
Houston				
Contract period 2000–2001				
Houston Works	Nonprofit	6,988,386		24,000,000
SER–Jobs for Progress	Nonprofit	1,311,072	1,176,734	3,144,020
Lockheed/ACS	For-profit	3,695,022		

Interfaith	Nonprofit	4,741,718		
Gulfcoast Careers of Harris County	Gov't entity	3,463,901		
Community Services Program of the AFL-CIO	Nonprofit	582,768	379,645	1,563,779
New York				
Contract period 1999–2002				
SAP Contractors				
Association for Research and Behavior	For-profit	17,797,500		
Curtis & Associates ^b	For-profit	26,932,500		
FEGS	Nonprofit	20,160,000	80,419,722	100,282,051
MAXIMUS	For-profit	3,000,000		
Goodwill Industries	Nonprofit	35,437,500	27,287,285	39,386,149
ESP Contractors				
America Works of New York	For-profit	30,630,000		
Career and Educational Consultants	For-profit	14,355,000		
Consortium for Worker Education	Nonprofit	8,250,000	33,836,345	7,531,841
New York Urban League	Nonprofit	10,197,000	4,780,896	8,182,268
Curtis & Associates	For-profit	35,805,000		

Table 2.2 (continued)

^a IMS was sold recently by Lockheed Martin to Affiliated Computer Services (ACS), a technology firm based in Dallas. ACS is a Fortune 1000 company that operates 79 one-stops with 59 contracts in 36 locations around the country. Because most of the contract activity analyzed here came before the merger, reference will be to Lockheed Martin IMS throughout.

^b Curtis & Associates was renamed Concera in 2002. In 1998, Benova Inc., headquartered in Portland, Oregon, was acquired by AFSA Data Corporation, itself a wholly owned affiliate of FleetBoston Financial Corporation. Benova acquired Curtis & Associates, headquartered in Kearney, Nebraska, in 2000. In 2002, Benova, Curtis & Associates, and the government contracting division of AFSA Data Corporation, headquartered in Long Beach, California, became the Concera Corporation. Concera specializes in contracting with federal, state, and local government agencies to provide a wide range of business process outsourcing solutions.

SOURCE: Information on assets and income from www.guidestar.org as of FY 2000. Blank = not applicable.

sold in its retail shops across the city. Goodwill uses these businesses to train the disabled, low-income populations, and youth for private sector employment. In an interview, CEO Rex Davidson identified the comparative advantages Goodwill has in philosophy and operations over its competitors (both for-profit and nonprofit) for Welfare-to-Work. Having its own business gives it independence in how it conducts on-the-job training. Goodwill's multiple funding sources—from its business activities and from philanthropy—reduce its dependence on government. "We have an efficient model to produce programs and service: we use for-profit management techniques and sophisticated systems of financial management which result in audits that always pass scrutiny," Davidson said. "We run businesses and embrace business-oriented management techniques. We are reliable, and our results are predictable. We have the lowest overhead in the country and can fund our operations up-front through high capitalization . . . We're here, and we'll be here when the money dries up." Furthermore, Goodwill supervisors can place clients in employment in their own industry. "We believe in the power of work," Davidson said. "If you don't work you can't learn to work . . . The dignity of employment—you can't replace that."⁷

Given its scale, reputation, experience, business-oriented values, and relationships with employers, Goodwill would appear to be an ideal contractor for the city. Indeed, it holds two of the largest contracts in New York City's reengineered welfare delivery system. However, challenges loom over the new mega-contracts. At a combined \$84 million for the two contracts over three years,⁸ the contract dollars represent three times Goodwill's asset base, an amount that makes the organization highly vulnerable to the city's funding and policy shifts. Although Davidson argued, "Competition is good. It makes us better, as long as it's not the be all and end all," Goodwill's performance at the time placed it below average among its competitors in the percentage of clients placed and in last place for retention—this despite its articulated commitment to follow up with clients on the job and its subcontracts with many CBOs that provide specialized services in the communities where they are located.⁹ Whether Goodwill's performance problems stem from the scale of its operations, the performance of its subcontractors, or the city's generally acknowledged difficulties in referring an adequate number of assessed clients, it is clear that even highly capable and experienced providers are having difficulties in this environment.

The big dilemma for the large, stable nonprofits is whether they will compromise their mission of putting the client first and providing to each client what he or she needs. Performance-based contracts and current payment levels favor rapid placement of clients and few specialized services, which must be paid for out of the fixed maximum payments for which contractors are eligible. Many of the nonprofit leaders we spoke to bemoan the structure and incentives of the contracts themselves. The Women's Housing and Economic Development Corporation (WHEDCO), unable, on its own, to compete for a prime contract, became a partner with America Works and a subcontractor to Wildcat Service Corporation in the reengineered service delivery system in New York. WHEDCO's president, Nancy Biberman, describes the problem this way:

The ESP [Employment Services and Job Placement] program and contracts were never intended to result in viable jobs for welfare recipients. The rapid reduction of the welfare caseload was the public policy mandate out of which the ESP program was created. The ESP contracts were children of shortsighted social policy and privatization ideology, which have proven both costly and inappropriate in the human services sector . . . The contracts were structured to provide financial incentives for 'rapid labor market attachment' (the expressly stated goal of HRA [Human Resources Administration] Commissioner Jason Turner). Consequently, at best they provided quick job placements and woefully unsatisfactory job retention outcomes. The policy has proven egregiously myopic. The current labor market contraction has left those with the poorest skills most vulnerable to layoffs. Had the ESP contracts been structured to enable participants to develop marketable skills before diving into low-wage dead-end jobs, perhaps long-term job retention could have been achieved. But the payment milestones in these 'performance-based' contracts, coupled with WEP [The Work Experience Program], forced even the most mission-driven providers into unconscionable work." (Biberman 2001, p. 4)

WHEDCO described itself as the poster child for employment and training providers because it embraces a holistic approach to meeting clients' needs. An association with America Works should therefore have boosted the visibility and legitimacy of America Works. In an arrangement brokered by the Local Initiatives Support Corporation (LISC), a community development intermediary, WHEDCO devel-

oped a for-profit subsidiary to partner with America Works on America Works' \$30 million New York City contract. But the relationship quickly soured. As its partner, WHEDCO found America Works' service to clients inadequate and saw its profit-maximizing behavior as robbing clients of needed support services. Indeed, as a mission-driven nonprofit that served more than 50 percent of America Works' clients, WHEDCO had to cross-subsidize its payments per placement from America Works with other resources in order to provide the needed support services for its clients. "We barely broke even on the arrangement because we provided layer upon layer of solid supportive services," Biberman said. "But it was our investment that made America Works' performance so good."

WHEDCO terminated its relationship with America Works in the spring of 2001 because of serious differences in approach and philosophy. America Works objected to the time and cost WHEDCO incurred in providing additional social services, thereby hurting its bottom line. WHEDCO claimed that America Works' highly favorable performance outcomes reflected the significant investment WHEDCO had made in supplementing services, not the placements America Works made itself. Regardless, the strategy seemed to work for America Works, which currently outperforms all other New York City contractors on both placement and retention.

The dissolution of this relationship reflects a considerable disparity of values and approach that many feel characterizes profound cultural differences in the way non- and for-profit providers approach their work. WHEDCO was bound by its social service mission and unwilling to capitulate to a bottom line regardless of the economic rationale for doing so. The tension between contractual requirements and mission appears less troubling to private sector contractors. Indeed, when we queried Ed Gund, senior vice president and chief operating officer at IMS at the time, about the conflict between mission and contractual demands, he responded, "The quality and character of services are all contract driven. If you want a particular service, put it in the contract."¹⁰ This was echoed by David Mastran, chief executive officer at MAXIMUS, a provider of program management, information technology, and consulting services to government agencies. "What gets measured and rewarded gets done," Mastran says.

Use of mechanisms like grant diversion and forming a temporary employment agency, which were central to America Works' strategy, appear less popular among other firms we have spoken to. With the exception of Seedco's limited liability corporation (LLC), few have used these mechanisms effectively and some, such as ARBOR, have rejected them outright, eschewing the documentation required and the loss in lifetime benefits that TANF clients experience when they use up precious months of their lifetime limit because of grant diversion.¹¹

However, when for-profits collaborate with nonprofits, culture clash is a more common theme. For many for-profits, the use of nonprofits and smaller proprietary providers as subs and partners is a short-term necessity if they are to meet the service demands of their many new for-profit contracts. But in practice, private and nonprofit cultures seldom harmonize. The large for-profits dominating this field see their role differently from most nonprofits. David Heaney of MAXIMUS in San Diego stressed the importance of selecting subs with "services you need, political influence, a good fit philosophically and organizationally, and [a compatibility with your] culture."¹² In Milwaukee and San Diego the use of subcontractors was crucial for increasing both capacity and breadth of services. Local subcontractors—especially CBOs—were important for their political influence and their knowledge of the local culture and community resources. "We made some stupid decisions by not understanding the culture—though we should have understood it," said Jerry Stepaniak, a MAXIMUS executive. "We were under great scrutiny politically and the [state legislative] audits revealed some insensitivities on our part; MAXIMUS drops in a new place where politics and community relations can be a problem. There is a huge advantage to knowledge of the community and political culture. We've figured out how to tap that, either by collaborating with nonprofit subcontractors, or [by] becoming a major subcontractor for a nonprofit prime."¹³

Subcontractors, too, were held to performance standards. "There are explicit criteria that these subcontracts must reach through retention and number served," said George Leuterman, Stepaniak's predecessor as vice president for welfare reform. "We are a business. We have a contract. We hold your hands to the fire. If you do well, you get a good reputation."¹⁴

YW Works in Milwaukee also formed an LLC with private sector partners but severed its relationship after the first contract period

for similar kinds of disagreements in style and values. Leuterman of MAXIMUS distinguishes between how for-profits and nonprofits view this work. “The county is our customer,” he says. “There is a power inequality with the client, and we recognize it. But the client is not your customer. They are not paying you. We provide services for our client, which is the county . . . Our motto is, ‘When you are doing something that is not in your contract, you are volunteering.’ The nonprofits have more flexibility.”¹⁵

Only in Houston, where contractors are paid on a cost basis for specified services up to a maximum, is there an incentive to vary the service package. Yet even in that city concerns have been raised about contractors choosing clients that are the easiest to serve to ensure higher success rates. The diversified funding streams that characterize many of the nonprofits, but none of the for-profits (like foundation and private fund-raising sources), can provide for cross-subsidy and cost-sharing among different programs, thus allowing them to pay for services clients may need but for which current contract amounts do not provide. Obviously the economic incentives built into these contracts offer much less latitude and pose a dilemma for mission driven nonprofits.

A recent development in Wisconsin following a state legislative audit in Milwaukee provides additional grounds for concern about the perverse effects—even for mission driven nonprofits—of the economic incentive central to the contract design (Johnson 2001). Milwaukee’s contracts are comprehensive and include eligibility determination in addition to job readiness and placement services. The Milwaukee W-2 Advisory Panel recommended changes in the Milwaukee program in response to revelations by state audits that relatively few clients were advised by contracting agencies of the range of available services for which they were eligible. Further, the audits confirmed that few had been given adequate assessment of their needs, had been lifted out of poverty, or had been placed in more intensive education and training programs that might have led to self-supporting jobs. The implications of the audits were that contract agencies simply didn’t offer services if clients didn’t request them. The money saved by not offering them, presumably, represented cost savings to the contractors and contributed to their profits.

In response, under a newly funded arrangement, the state has allocated \$5 million for a contract for county workers to assume the role

at the “front door,” undertaking client assessments and informing them of the services for which they are eligible, including job training and food stamps. Then they will be referred to the appropriate W-2 agencies. These changes are designed to insure that clients are made aware of their entitlements and the supportive services available. The need for changes like these, however, illustrates the potential conflicts between the cost saving (profit maximizing) incentives inherent in performance-based contracts and serving clients’ interests. The legislative audit uncovered evidence of potentially serious consequences of the economic incentives inherent in the contract’s design, absent systems to insure appropriate monitoring and accountability. These were dangers generally thought to exist only when for-profit firms provided the services: most observers viewed the values of nonprofits and their missions as insurance against contractual abuses. But both were found to have denied clients critical access to information about their eligibility for additional services and program resources. Whether or not these oversights were necessary to meet contract demands, we see that nonprofits may be forced to capitulate to market pressures, compromising their values to remain competitive with for-profits.

LIVING BY THEIR WITS

Large, stable nonprofits with large and diversified funding streams appear relatively secure. In many ways they resemble their for-profit competitors more than they do their leaner, less business-oriented counterparts among nonprofit providers.¹⁶ But many nonprofits in the employment and training business that we spoke to are facing an insecure future in a changing environment. Some of the medium-sized and smaller organizations are regrouping, shifting their focus and looking for alternative sources of both government and private funding. These efforts to survive combine a search for new dollars, development of new areas of program growth, investments in improved management to achieve cost savings, and some efforts to embrace private market techniques. Some have developed for-profit subsidiaries to realize some of the benefits that accrue to the for-profit providers. Catholic Charities in San Diego was typical. That provider underwent a significant management reorganization, including the development of a more professionalized set

of management and personnel systems, and introduction of a new generation of technology and information systems in order to be competitive and manage its recent contracts with the county. Similarly, Houston Works has modernized to such a degree that some contractors we interviewed described it as having become the leading edge in business technology—comparable to industry leaders like the for-profit Lockheed Martin IMS (now ACS State and Local Solutions—see Note 10).

A particularly innovative effort characterized one of the smaller nonprofits that won a \$7.4 million contract in New York. Seedco, a highly respected medium-sized nonprofit with areas of investment that include community and economic development, workforce development, and housing, has built a collaborative with 15 CBOs. It provides them with technical assistance while helping them to provide employment training and job placement to TANF recipients under the New York City contract.¹⁷ Organized as a subsidiary to the nonprofit Seedco, the Non-Profit Assistance Corporation (N-PAC) has structured a limited liability corporation named EarnFair to take advantage of a variety of private sector incentives such as the ability to use allowable tax credits as an eligible employer of welfare recipients. As an LLC, EarnFair can operate as a temporary employment agency and syndicate these tax credits, using the additional resources from their sale to subsidize increased and more intensive services to the clients it serves. Further, the N-PAC subsidiary runs the Welfare-to-Work program using the collaboration of CBOs and generates additional funding from a diverse set of resources including philanthropic and other public funds.

Seedco's president, Bill Grinker, an innovator in human services and a former HRA commissioner himself, described the vision this way: "We view ourselves as a management service entity. The key service provision is provided through CBOs. Our interest is in providing information systems, capacity, financial assistance, and technical, programmatic types of supports. While theoretically we are the prime contractor, we view the CBOs as partners rather than subs . . . Even so, these CBOs would most likely be closed out of these contracts had they not been able to come under the umbrella of a well managed, fiscally sound prime."¹⁸ In actuality, N-PAC functions as a conduit for resources and information, "pooling together public and private grants and funds that it passes on to the subcontractor," said Tracie McMillan. "As a result, N-PAC has to rely on job placements for only 50 percent of

its funding, freeing up considerable resources to invest in longer-term training” (McMillan 2001). Perhaps most important, Seedco manages the financial risk for the CBOs by basing their payments only partially on performance and the rest on a line item cost basis. The transparency with which each partner shares the performance data of its other partners creates pressure on each to be accountable.

The \$7.4 million contract from the city represents only 20 percent of the resources N-PAC is allocating to this effort. The rest comes from the syndicated tax credits; other partners such as the United Way; the New York Community Trust; and LISC, a community development intermediary. These resources allow innovative programmatic designs that go well beyond what competitors could provide, specifically the for-profits. Indeed, the EarnFair model provides post-placement support services and case management for participants for two years. It operates as a temp agency but provides supervision of workers after placement with a private employer and provides additional supports on the job, including transitional services, fringe packages, counseling, and financing. Total wage packages are assembled that include the value of the Earned Income Tax Credit (EITC). “The EarnFair Model is a good example of Seedco’s high standards for all our products,” said Diane Baillargeon, Seedco’s senior vice president. “The program design itself embodies some of the best thinking in the Welfare-to-Work field about effective interventions. We also have in place a plan for long-term financing. We’re not looking for financing that consists of one big government contract, but for diverse revenue streams. Having seen nonprofits struggle when government contracts are cut, or living hand to mouth year after year, it’s exciting to me to be working on economically sustainable financing for social purposes” (Seedco 1999).

A nonprofit in Milwaukee developed a simpler yet still innovative partnership to bid for a contract in that city. The YWCA partnered with CNR Health and the Kaiser Group to form a limited liability corporation to bid in one of Milwaukee’s five contracting regions. In this arrangement, the YWCA became the managing partner of YW Works, controlling day-to-day operations, while Kaiser and CNR Health provided many of the management systems and technological supports (Yates 1997).¹⁹ The Y had “a lot to bring to the table” since it had been involved since the 1920s in employment and training—especially non-traditional training for women, Rita Rinner, YW Works’ chief operat-

ing officer, reported. When the first requests for proposals (RFPs) were released in Milwaukee for W-2, she said, “we wanted other expertise. We felt it was too risky to go it alone. CNR was a software developer, and we worried about the size of the budget and the risk of debt from a capitated payment if we failed. We needed technology, an MIS system, and help with reporting systems. Partners could help.”²⁰

These kinds of partnerships allow nonprofits to capture the benefits of private sector capital, efficiencies, and management expertise while operating in a manner consistent with their missions. Private sector partners helped to underwrite the risk, hire staff, and build needed infrastructure. In the second round of Milwaukee contracts, however, YW Works dissolved the relationship and bid alone. Whatever the initial advantages, cultural differences in style and values plagued the relationship. Once YW Works felt confident of its own managerial and technological capacity, it was less dependent on the partnership. Its private partners lost some interest as well. They found the environment and the bias against for-profits inhospitable. The political heat and the controversy that typically accompany the entrance of for-profit providers into a service area historically dominated by government and nonprofits made the arrangement uncomfortable. County providers around the state “have the view that private agencies can’t be responsible with public funds,” Rinner said.²¹ But the arrangement served the short-term transitional needs of the Y and helped set it up for an independent operation with the capacity to go it alone.

Innovative partnerships served some nonprofits well. But other traditional employment and training providers were scrambling to stay in business. Many viewed the payment levels and schedules as unrealistically low under these contracts. A smaller contractor in New York who was unable to bid directly on any of the contracts became a subcontractor under two of the primes (one for-profit and one nonprofit). “Our reimbursement as a sub won’t cover our costs,” she said. “We’ll have to fundraise to cover costs . . . But our key advantage is our diversified funding. We see government contracts as defraying costs, not covering them.”²² That observation rang true for Liu in Houston as well. “If you [as a local CBO] rely totally on government money,” she said, “it is almost impossible for you to survive.”²³ The contracts provide no incentive for long-term investment, and for the subs who must relinquish overhead to the prime, current payment schedules may pay only a frac-

tion of the true costs of serving a disadvantaged client. But accepting these subcontracts allows for financial piggybacking and economies of scale in multiple program cost-sharing.

For small nonprofits, whose financial solvency depends upon their performance, reasonable numbers, high quality referrals, and timely payment for performance (which depends upon the administrative performance of both the county or city and the prime), the financial risks are clearly high. A generalized concern among the nonprofits we spoke to, all of whom are acting as subcontractors, had to do with referrals. They feared, first, that the city would not refer sufficient numbers of eligible clients in a timely fashion to the prime to support the heavy investment in program operations. And worse, they feared that the primes might ‘cream’ the most job-ready clients for themselves and refer out the most difficult and costly to place—those with multiple barriers to employment.

Diane Baillargeon was senior vice president of Seedco at the time I interviewed her and wrote this chapter; she now is president. Baillargeon is familiar with the plight of many CBOs. “There are already nonprofits—mostly small, relatively low capacity community-based organizations—[that] have gotten out of the business,” she reported, “and I know personally of a number of organizations that simply have said, ‘We can’t compete in this business any longer,’ and they have gotten out of it. Now, most of them are multiservice, social service, community-based community centers, and they are still operating their domestic violence program and their homeless shelter and all of that, but they are no longer in the workforce business. And I think that’s a loss.”²⁴

In Houston, the system is designed to provide “customer choice.”²⁵ No contract is signed with subcontractors and CBOs. Instead, training providers are chosen by the clients themselves after being counseled and given provider information by contractors at career centers. This system wreaks havoc on providers’ planning processes, since they are unable to anticipate the demand for their services and the staffing those services might require. Furthermore, in order to attract and keep clients, they must provide considerable information and do aggressive marketing. These are investments that they have no assurance they will be able to recoup, and ones for which they typically haven’t much expertise. Often CBOs invest considerable resources in initial recruiting and training before they refer clients to career centers to be certified, hoping they

will return for more intensive services. These up-front investments are difficult for smaller nonprofits and CBOs to finance themselves. The process, known as reverse referrals, was seen as extremely costly for the nonprofits, but also necessary to ensure that at least some initial contacts would return to their organization. If they fail to find and attract a sufficient number of clients—who after all have a tremendous number of choices (over 6,000 qualified providers at last count)—thousands of traditional nonprofit providers may be forced to close their doors, seek new funding streams, or refocus their efforts on new service areas.

The current strategy of the municipalities we studied has been to find a few experienced contractors with good track records and sufficient technological and managerial expertise to provide the services and information necessary to ensure full participation and job placement of all eligible clients. Federal mandates and the terms of performance-based contracts require information systems to track and verify the progress of all clients in the system, and these demands often require sophisticated technology and management systems. Many of the for-profit providers have considerable advantages in providing these systems. Indeed, Seedco used the philanthropic resources it raised for its innovative effort to purchase MIS software from a subsidiary of MAXIMUS—allowing it the same kind of capacity for its LLC as the for-profit firms. But the development of these systems is expensive, even if they are bought “off the shelf,” and few small organizations have the resources for those kinds of investments.

In New York and Milwaukee, nonprofit providers have had a long history and good performance record of providing employment and training services, yet many lack the necessary technological and managerial systems to manage performance-based contracts. Further, because the timing of payments depends on contractors’ performance in Milwaukee, New York, and San Diego, and on systems to verify placements, considerable up-front capital is necessary to undertake these contracts. The for-profits have quite a few advantages over the nonprofits in assuming the risks. They have greater capacity to sustain operations in anticipation of future payment streams, since they have access to investment capital. Only a fraction of the nonprofits historically operating in the employment and training business have the ability to stay the course while they wait for payment. So serious was the threat to contractors in New York that the City was forced to provide some

up-front working capital to float the start-up cost of their large TANF contracts.

Clearly the availability of working capital, an asset more likely to characterize the larger for-profit companies, is a key factor in how competitive nonprofit providers can be over time. As Richard Shaw of the Houston AFL-CIO put it, "First you have to have the money to spend the money, which is a real problem for small companies."²⁶ How well capitalized an organization needs to be to remain solvent in this environment depends in large part on the competence and efficiency of the public agency responsible for reviewing and authorizing payments. Timely and accurate payments and an adequate flow of client referrals to providers are an indication of the management systems and capability of public agencies, and their recent track record is not encouraging. Even large, well-managed nonprofits such as Goodwill and Wildcat worried about the city's capacity to insure that these functions ran smoothly.

New York's HRA has been notoriously poor at paying its vendors in a timely manner. So problematic has been this lack of capacity that the City has had to advance most of the contractors payments of up to three months to keep them afloat. The City has launched a new computerized system to receive vendor placements, make referrals, and speed up the process of calculating and verifying payments. Although the system promises to improve upon the City's speed of payments, as recently as 2002 vendors still complained about the backlog and the amounts they were owed. This falls particularly heavily on subcontractors whose payments flow from the City to the prime and then on to them. Biberman of WHEDCO, which subcontracts for two large primes, found her organization caught in the middle. "One of the most debilitating footnotes to this story involves untimely payments of the paltry funds available under these contracts," she said. "At any given time, our organization awaited at least \$100,000 in receivables from prime contractors. We had no recourse to the City, although we tried. Indeed, when we learned that a prime contractor had already been paid by the City for the work we had done, the City officials told us that we should sue the prime for payment!" (Biberman 2001).

The concern over the ability of cities to refer clients resonates around the country. "It is the biggest issue we face," said Holli Payne of MAXIMUS. "It really is like pulling teeth trying to get these clients out

of the system. The bureaucracy is horrible. For example, in Philadelphia there are 65,000 clients on welfare. MAXIMUS had a contract to serve 200, yet the City could not produce that many people for MAXIMUS to serve. They are inefficient and ineffective.”²⁷

ON THE BRINK

Smaller, community-based nonprofits, which historically have provided employment and training services to low-income populations, represent a large and diverse group nationwide. Before the Workforce Investment Act of 1998 (WIA), there were 163 federal programs that funded employment and training. Under these titles, tens of thousands of nonprofit and for-profit organizations have received contracts and grants. In New York City alone, more than 115 individual providers had one or more employment and training contracts under federal titles prior to the newly awarded TANF contracts and the commencement of the WIA programs.²⁸ Their capacity to compete in a more performance-based environment varies enormously, but most of the organizations we spoke to believed they would “get by” in the short run. Few small organizations had the ability to bid on the TANF contracts given the scale and organizational capacity requirements they entailed, and those that did often did so as a collaborative, such as in San Diego. There, a collaborative of nonprofits in the South Bay community bid to serve that community as the Metropolitan Area Advisory Committee. They did not, however, win the contract and are currently litigating the decision, questioning the fairness of the bidding process. In New York, where the bidding process was not the typical open competitive process but a negotiated acquisition, the city invited organizations to bid, and many historical small nonprofit contractors were closed out. A number of small, experienced providers lost their contracts with the city in what has been described as a shakeout.

Because of the scale of these efforts, however, most of the prime contractors in Milwaukee and New York by necessity have either solicited CBOs or responded to CBOs’ requests to act as subcontractors or link with these organizations to provide training and support for clients with special training or social service needs. Under current bidding processes to select providers to serve TANF clients, many his-

torical providers will continue to serve portions of the caseload, albeit to a limited extent. (There will be additional opportunities for many of them to compete for clients under the U.S. Department of Labor's (USDOL) WIA programs, but success under that system depends primarily on the selection of a provider not by jurisdiction but by customer.) Furthermore, many of the national for-profit providers (and large local nonprofits) like ACS State and Local Solutions and MAXIMUS have selected CBOs as subs, in part to mitigate the political backlash against them in the communities where they have won contracts. Subcontracts with CBOs have a number of valuable practical and political payoffs as for-profits enter new markets. In the short run they can learn from CBOs, which have a better understanding of particular client needs and a connection to the resources in the community that serve them. Beyond that, their association with well known and trusted community organizations provides some political cover, helping to co-opt and deflect criticism from groups that might otherwise be their opponents.

For the time being, then, many CBOs and smaller nonprofits may survive, even as they scramble to change their programmatic focus, seek other sources of public and private support, and serve the short-term needs of large contractors. Over the longer term, most observers we interviewed predicted that many of the weaker providers would scale back or close down. Since the industry varies enormously in quality and fiscal soundness, the consequences for many small providers may be dire. Their loss will have a mixed effect on the quality and range of available services.

Many small providers serve populations with special needs. Anita Moses, a small contractor who lost her contract when the city of New York reorganized its delivery system, said the old system had its merits. "Good CBOs in communities are linked to providers and understand the needs of their clients," she said. "You have them and you know them. Some CBOs are bad, some mediocre, but CBOs have unique advantages."²⁹ For example, The Chinatown Manpower Project in New York has historically served Chinese speaking clients, whose ability and willingness to benefit from training and employment services provided by a borough-wide contractor under the new service delivery arrangements are limited. Whether current contracting and referral arrangements can preserve the services that may be critical to special populations located in particular communities is questionable. Many fear that populations

like ex-offenders, ethnic populations, and drug addicts may be poorly served. They also worry that welfare applicants from these groups, when they are diverted to job placement and employment training, may simply disappear, falling through the cracks of a system that has no capacity to meet their special language and cultural needs.

The career center contractor we spoke to in Houston, as well as interest groups there, fears the consequences of this shakeup. "In my opinion, when we lose the little guy [e.g., the small CBO], we lose the hard-to-serve clients, because that is who they trust and who they go to," said Lockheed Martin IMS head Carol Anderson. "They are not coming to my career center because I am there. They have to feel some reason to be comfortable and safe to come. When we lose the contract, we lose a lot."³⁰ But other observers saw the possible thinning of the provider ranks as being healthy, by reducing the number of weaker and less able providers and strengthening the field overall.

The smaller nonprofit contractors in Houston "do a lot more than what the performance standards measure," says Jesse Castanada, head of a CBO there, yet their dedication to their mission does not allow them to cut services even if current contract arrangements fail to reimburse them for their additional costs.³¹ Mission drives the service policies of Castanada's organization, SER—Jobs for Progress of the Texas Gulf Coast, but two of the smallest CBOs with contracts have been placed on probation and threatened with contract revocation because of the difficulty they have had in getting their operations off the ground, and in part because of their unwillingness to capitulate on their service commitments in order to adhere to the economic realities of their contracts.

There is evidence that New York City's HRA is worried too. Current contract designs that provide incentives for immediate placement but allocate limited resources for longer-term support have not fared as well as expected. A recent summary on placement and retention rates of ESP contractors revealed average placement rates of 29 percent and retention rates of 9 percent at 90 days and of only 3 percent at six months. (Individual contractor performance varies greatly; retention rates at each milestone range from 2 to 28 percent and from 0 to 14 percent respectively.)³² Many view the poor performance, especially in job retention, as being due to the lack of intensive services for clients

with special needs. Historically, the providers most often serving these populations have been the CBOs.

So much controversy has attended the poor performance of and the weak support for CBOs in the contracting system that the city of New York recently awarded, through a negotiated acquisition process, 30 new contracts to serve special populations under WIA. The contracts were awarded exclusively to nonprofits, mostly CBOs. This represents a big victory for advocates who have questioned the viability of the current contracts to serve a caseload marked by daunting labor market barriers. It also reflects the city's increasing recognition that job retention among all contractors is very low. While only 21 contracts have so far been registered, these alone represent a large additional city investment in CBOs providing support services for the most difficult and vulnerable parts of the caseload, those clients with multiple barriers. The signed contracts already total more than \$75 million. Although quite recent, they will provide sizable cash advances, more adequate funding, regularized reimbursements, and a recognition of the more intensive service needs that some clients have if they are to enter into and retain employment.

While risks abound for CBOs, the organizations themselves vary enormously in capacity, resourcefulness, and promise. Bill Grinker of Seedco's N-PAC described those nonprofits living on the brink as "a mixed bag in terms of capacity and ability to survive. Many will remain subs in the short run." The problem over the long run will be that, as the for-profits develop connections in the community, they will have less need for these CBOs and greater incentive to save the overhead devoted to managing them. Even for those CBOs that currently have contracts, there is the question of whether performance-based contracts will drive them out because of their lack of capital to sustain themselves while they wait for payment. Grinker also questioned whether the for-profits would continue to need the political protection they now enjoy through the connection they have with CBOs that serve as their subs. Moses, the long-term city employment contractor who lost her contract when the city administration reorganized service delivery in New York, viewed the selection process as entirely politically motivated, granting large contracts to mayoral favorites, politically connected for-profits, and large, established nonprofits. "What we will lose is the human element," she says. "Smaller providers are better than larger ones. Small

nonprofits are driven by values and mission, and their staff is more concerned with people than numbers. All this gets lost in bigness—clients get lost.”³³

Richard Bonamarte, formerly the HRA executive deputy responsible for designing the original contracts, explained that the decision to select a few large contractors was based on a recognition that a major employment engine was needed to manage the large flow of clients, and that that would require providers whose scale of operations, systems capacity, and experience could handle a performance-based environment. Yet the design made an express attempt to protect the survival of the CBOs. “Many nonprofits, especially CBOs, have limited cash flows, low surpluses, and no professionalized financial systems and management capacities to deal with performance-based contracts,” he said. “A major idea behind these contract designs was to allow smaller nonprofits to work as subcontractors under the primes and to reduce their exposure, to protect them and nurture them. They [the smaller nonprofits and CBOs] represent much of our infrastructure, and infrastructure takes so long to develop . . . You don’t want to lose community-grounded organizations.”³⁴

Ironically, the CBOs see their exclusion as prime contractors in the selection process and their limited role as subcontractors as a repudiation of their contributions, and as the cause of their current problems. New York subcontractor Biberman described the situation facing nonprofit subcontractors as morally and financially untenable:

The private and nonprofit contractors tend not to subcontract; the nonprofit contractors do more of it. In either case, prime contractor and subcontractor survival is predicated on doing as little work as possible. The city pays the primes only when they have certified that a recipient is in the labor force. *For the average community-based subcontractor, \$1,700 is received at initial placement, \$1,300 at 90-day job retention and \$200 at 180-day retention!* Simple calculus coupled with the suspension of social mission drive[s] the implementation of these contracts in one direction: *placement only* . . . The subcontractors in these contracts are losing their shirts, both in financial terms and in the mutilation of their social missions, not to mention the morale of their staffs . . . Honorable community based subcontractors cannot[,] in conscience, work in this way; and so through philanthropic help and often at

serious financial peril, they cobble together literacy assistance, social services, child care, etc. (Biberman 2001)

Thus, while small nonprofits have the motivation to stay alive and fulfill their mission, few have the resources and capacity to compete on their own, and many fear that, even as subcontractors, their future is in doubt. They complain of inadequate payment by the primes and of documentation and information processing demands that are as excessive and costly as when they reported directly to the city. In San Diego, contractors with case-management contracts refer clients to CBOs for particular services, but payments are capped, and performance-based contracts may impose severe constraints on small organizations that must wait for payment until a client has been employed and retained for up to six months. In Houston, where the contracts for case management at one-stop centers merge TANF clients with others served under USDOL titles, clients themselves select from the service providers that the city has qualified as eligible. Nonprofit and for-profit providers, therefore, compete for clients, and those with better connections and marketing expertise are likely to win out. Many CBOs have trouble competing in this environment.

CONCLUSION

Nonprofits are clearly sailing in uncharted waters. The new demands on nonprofits to compete in a reengineered welfare delivery system where market forces compete with traditional values has created real hazards. When missions collide with financial, managerial, and programmatic imperatives induced by new contractual arrangements, many nonprofits are forced to question their traditional roles as protectors of the poor and champions of progressive social values. Even so, many have adapted creatively to the new challenges, improving their performance, competing effectively on price, and developing innovative means to protect their missions. Many others, however, are struggling.

Much has been made of the inherent disadvantages that many nonprofits have in the new welfare service delivery markets, where they now compete with large, national for-profit firms (Ryan 1999; Frumkin and Andre-Clark 1999). They lack the management systems and the

information technology needed to manage large and complex contracts. They have a comparative disadvantage in attracting government executives with welfare expertise, and they are constrained by their nonprofit status from raising capital in the financial markets. They lack both the capacity and the experience to handle the scale of operation that new contracts require. These are formidable handicaps.

But nonprofits in this industry have considerable strengths that national for-profit providers lack. As Baillargeon said, “They’re really known entities in the community that they serve, they have a respected level of cultural competence, they offer other kinds of services, they already have preexisting connections to the target populations that we’re talking about. I think, in fact, they will do very well.”³⁵ Besides those attributes that Baillargeon ticked off, nonprofits have the ability to fundraise both from individuals and from major philanthropic organizations. These resources allow them to enrich their programs and provide additional services that contract dollars might not cover. In that respect they can often offer higher quality services than their for-profit competitors.

But we have seen that nonprofits providing welfare services vary as much from one another as they do from their private sector competitors. And many traditional providers have been closed out of the reengineered delivery systems we have studied. As a consequence, the adaptations nonprofits have made and their success in meeting the challenges show considerable variation. Some of the large, experienced nonprofits have a solid foothold in the markets we examined and appear to be holding their own. The speed with which all contractors have had to gear up, transform their systems, hire staff, and achieve placements has strained the resources of everyone we interviewed—profit and nonprofit alike. Early implementation has been rocky in many cases. While few data are available on the relative performance of individual contractors and subcontractors, the numbers we have uncovered in New York and San Diego suggest that no single factor can explain the wide variation in prime contractor performance in placements and retention. There is no obvious or consistent pattern by size of contract, size of organization, or sectoral status.³⁶ Since in theory referrals are randomly allocated by borough in New York, differences in client characteristics cannot explain the bulk of the disparities we observe. Start-up problems—many of which were the result of the city’s performance—no doubt explain some of the variations. But nonprofits competing as primes appear, in

general, to be no better or worse than their private sector competitors.

Competition first confronted these vendors when they had to respond to an RFP, and few made the initial cut. Existing providers, therefore, are likely to be those that were strongest. For example, Opportunities Industrialization Center (OIC) and United Migrant Opportunities Services (UMOS) in Milwaukee and Federal Employment and Guidance Services (FEGS), Wildcat, and Goodwill Industries in New York are big operators that have had a long history of public service provision. They were the most likely to succeed. Thus, the selection of a few experienced organizations, most of which were well-respected (and politically connected) providers in the community, left many CBOs and small and medium-sized providers out of the game. Few even had the ability to bid on these contracts, given the contracts' scale and organizational requirements. These CBOs' role as subcontractors has been more limited, and their success is still in question. Little technical assistance or management support has been available except in a few cases such as with Seedco's N-PAC, whose very design is structured to allow it to play the role of a management services entity.

Efforts like the one that created N-PAC are the sorts of highly focused initiatives that have the potential to sustain high quality operations that include smaller organizations in collaborative arrangements by which they can share resources and management systems. Networks of agencies can consolidate functions and share administrative tasks, and as a group they may be in a better position to attract funding, contracts, and capital financing. Some cost-sharing, particularly when it comes to expensive overhead, can help financially strapped smaller agencies be better able to compete for the available resources of intermediaries. It is also a promising strategy for strengthening the chances of experienced, mission-driven organizations threatened by new contracting arrangements.

These kinds of innovations—formed through collaborative and creative partnerships, assisted by private fundraising and changes in status (the development of a for-profit subsidiary)—represent healthy and promising adaptations. But, again, these are the exceptions. Most smaller nonprofits are having a hard time of it, and squeezing profit margins will retard creativity and productivity among even the most competent providers. Worse, such pressures will threaten the organizational mission and human service values that make nonprofit providers

uniquely qualified to undertake some of the most difficult and important services now being outsourced. And those are the risks that attend the survivors. Others may simply disappear. As organizations learn to adapt to new funding, service, and management imperatives, so too must local governments adapt their program designs. Contracting is popular, but it is hard to do well, especially for providing human services. Public, nonprofit, and private providers have different comparative advantages. Evaluating the relative risks and rewards of various arrangements and choosing carefully requires experience and an interest in analyzing the impacts of alternative designs.

The dilemma involved in the design of New York City's performance-based contract is instructive since within it reside the incentive structures that affect the behavior of contractors. Paying too much for initial job placements and too little for job retention (in quality jobs with good pay and benefits) encourages contractors to provide little service or effort to find good jobs. But placing too much of the payment on the back end may impede cash flow and cripple contractors' ability to stay afloat. Thus, contract design needs to balance optimizing cash flow to contractors with setting milestones at the desired levels. It's a balancing act among three desires: to reduce program costs, to improve service quality, and to insure the fiscal stability of the contracting organizations. This is more art than science. But if employment training is to achieve its promise in a resource constrained environment, it will require more than the adaptation of nonprofit providers to demands for efficiency. Local government must do a better job of learning, through multiple iterations of contract design, to identify the right balance of incentives and supports. Only in this way can it preserve the viability of mission-driven and innovative nonprofits and allow them to compete without losing their souls.

Notes

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1. Twombly's research points to the greater ability of larger, older nonprofits providing core welfare reform services to survive changes to the environment induced

- by welfare reform. In part this reflects the longstanding relationships older non-profits have with funders and other groups that may have buffered their operations. See also Twombly (2000a).
2. Nancy Liu (executive director, Chinese Community Center, Houston), interview by Philippe Rosse, August 3, 2000.
 3. Sister Ramonda Duvall (executive director, Catholic Charities, San Diego), interview by the author, July 20, 2000.
 4. Richard Shaw (chief executive officer, Community Services of the AFL-CIO, Houston), interview by Philippe Rosse, August 1, 2000.
 5. Amalia V. Betanzos (president, Wildcat Inc., New York), interview by the author, May 16, 2000.
 6. Ibid.
 7. Rex Davidson (chief executive officer, Goodwill Industries of New York), interview by the author, June 7, 2000.
 8. Goodwill won a \$35.4 million Skills Assessment and Job Placement (SAP) contract for October 1, 1999–September 30, 2002, and a \$49.4 million Employment Services and Job Placement (ESP) contract for December 1, 1999–November 30, 2002.
 9. At the time of this writing, Goodwill had 12 subcontractors.
 10. Ed Gund (chief operating officer and senior vice president, Lockheed Martin IMS), interview by the author and Paul Light, January 12, 2000. In 2001, the Lockheed Martin Corporation sold IMS to Affiliated Computer Services, which renamed it as its State and Local Solutions group. The IMS Corporation included Children and Family Services, Information Resources Management, Municipal Services, Transportation Systems and Services, and Welfare and Workforce Services.
 11. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) created a five year total lifetime cap on benefit receipt. Employed recipients whose jobs are partially financed through grant diversion run down the clock on this cap during their period of employment.
 12. David Heaney (project director, San Diego, MAXIMUS), interview by the author, October 30, 2000.
 13. Jerry Stepaniak (vice president, welfare reform division, and project director, Milwaukee, MAXIMUS), interview by the author, April 25, 2001.
 14. George Leuterman (former vice president, welfare reform division, MAXIMUS), interview by the author, January 13, 2000.
 15. Ibid.
 16. In a paper titled “Nonprofit Organizations in an Era of Welfare Reform” that was presented at the 1997 meeting of the Association for Research on Nonprofit Organizations and Voluntary Action (ARNOVA), Carol J. DeVita and Eric Twombly used 1992 and 1994 IRS data to examine the number, types, and financial stability of human services organizations most likely to be affected by welfare reform. Of these, 83 percent offered core services. The study shows that these organizations faced financial uncertainty and increasingly stringent budgets. As a result only 41 percent reported positive net balance sheets for 1992 and 1994. De Vita (1999)

subsequently reported on these findings in her chapter of the Boris and Steuerle book.

17. Diane Baillargeon, senior vice president of Seedco and chief operating officer of the Non-Profit Assistance Corporation at the time, said as a Brookings Forum panelist in 2001 that Seedco had a waiting list of nonprofits that wanted to work under its umbrella, but the size of the contracts limited the number Seedco could work with, because it was at capacity. (Brookings Forum, "A View from the Frontlines: Innovations in Delivery of Welfare Services," Washington, DC, October 17, 2001.)
18. William Grinker (then-president of Seedco and its affiliate, N-PAC, of New York), interview by the author, May 18, 2000.
19. Rita Rinner (chief operating officer, YW Works), interview by the author, April 23, 2001.
20. Rinner, interview.
21. Ibid.
22. Rachel Miller (vice president for operations and fiscal affairs and director of workforce development, WHEDCO, New York), interview by the author, July 17, 2000.
23. Liu, interview.
24. Baillargeon, Brookings Forum.
25. This model is the prevailing one under the U.S. Department of Labor's Workforce Investment Act of 1998, which provides eligible clients with independent training accounts (ITAs) to use for training with qualified providers.
26. Shaw, interview.
27. Holly Payne (director of welfare services, MAXIMUS), interview by Paul Light, June 8, 2000.
28. Data provided by the New York City Comptroller's Office and the mayor's Office of Contracts.
29. Anita Moses (president, Education and Planning Institute, New York), interview by the author, June 27, 2000.
30. Carol Anderson (executive director, Lockheed Martin IMS, Houston), interview by Philippe Rosse, August 5, 2000.
31. Jesse Castanada (president, SER-Jobs For Progress of the Texas Gulf Coast), interview by Philippe Rosse, August 4, 2000.
32. Data provided by Swati Desai, executive deputy administrator for policy and program analysis, New York City Human Resources Administration.
33. Moses, interview.
34. Richard Bonamarte (former executive deputy administrator for contracts and procurement, New York City Human Resources Administration), interview by the author, January 25, 2002.
35. Baillargeon, Brookings Forum.
36. Public Assistance (PA) Summary Report, provided by Swati Desai, executive deputy administrator for policy and program analysis, New York City Human Resources Administration.

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